

Proposal for minimum environmental standards for financial products belonging to the Art.9 and 8 categories of SFDR

Position paper from the AMF

The *Sustainable Finance Disclosure Regulation* (SFDR), adopted in 2019, was designed by the European co-legislators and the Commission as an ESG transparency regime applying to financial entities and products.

Contrary to a labelling mechanism, SFDR does not set out any minimum expectations and only requires financial actors to disclose information about their claims and practices on sustainability matters.

Therefore, SFDR and the current “Article 9” and “Article 8” classification does not help appreciating the extent to which financial products and their investments are sustainable. In that respect, the notion of “sustainable investment” set out in Article 2(17) of SFDR is worded in vague terms, and its implementation by financial actors has resulted in very different understandings of what sustainability is.

Thus, it appears that SFDR has (i) created a gap between the reasonable expectations expressed by investors and the reality of the practices and (ii) fuelled the greenwashing. Divergent interpretations and frameworks have emerged, fragmenting the single market and hampering the financing towards a more sustainable European economy.

The *Autorité des marchés financiers* (AMF) conducted an informal consultation with financial actors and reached the conclusion that, to reduce greenwashing, it is paramount that the European Commission introduces minimum expectations that financial products should meet to be categorised Art.9 or Art.8 under SFDR. We therefore make the following proposal of minimum environmental standards:

1. Considering that Art.9 and 8 categories are widely recognised in Europe, **the Commission should maintain them while introducing minimum standards that a product shall meet in order to be classified in either category.** Compliance with the minimum expectations attached to each category would be subject to national supervision. The criteria attached to the Art.9 category should remain more demanding than those for the Art.8 category. Transparency requirements currently applicable to Art.9 and 8 products should continue to apply, including to products that will not meet the future minimum standards for these two categories.
2. **The vague definition of *sustainable investment* should be clarified to become tangible.** For this purpose, Article 2(17) of SFDR should be replaced by a new definition built on objective requirements. Those should consist of a minimum product alignment with the EU Taxonomy that defines environmentally sustainable activities (see recommendation 3). Such a change should be coupled with a removal of the current Commission interpretation (as per its Q&A of July 2021) whereby Art.9 products may only include sustainable investments (without prejudice of investments made for liquidity and hedging purposes). In addition, the new definition could be extended to cover investments in “transition assets” (see recommendation 8).
3. **A minimum proportion of Art.9 products’ underlying assets should consist of investments in activities aligned with the EU Taxonomy.** This percentage should be dynamic and evolve upwards in predefined steps to take into account the evolution of the EU economy towards sustainability. Therefore, this minimum requirement could be formalised as follows:
 - An initial percentage, set above the current estimated alignment of the EU economy [no less than x%];
 - A subsequent, step-by-step increase of this percentage, depending on how the EU economy’s alignment with the Taxonomy progresses over time;
 - A grandfathering clause should be provided specifically for closed-ended funds. [An Art.9 product should commit to the minimum percentage in force at the time it is made available to investors.]

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4. **Manufacturers of Art.9 and Art.8 products should be required to adopt a binding ESG approach when taking investment decisions regarding the underlying assets of such products.** The EU framework for minimum standards would identify a set of acceptable ESG approaches which a financial actor may implement for its financial products to be classified Art.9 or Art.8¹, setting out the conditions under which such approaches may be deemed to be sufficiently binding², for instance by defining a certain degree of reduction of the investment universe. Some other specific approaches could be approved on a case-by-case basis by NCAs where duly justified, for instance in the case of investments in real estate assets or private equity.
 5. **Art.9 products should exclude investments in fossil fuel sector activities that are not aligned with the EU Taxonomy. As regards Art.8 products, investments in such activities are possible provided strict conditions are met** that guarantee that such activities are committed to an orderly transition. This could include for instance a requirement that the investee company has adopted and duly executes a convincing transition plan. This transition plan should be reported in accordance with the Directive (EU) 2022/2464 (Corporate sustainability reporting Directive, CSRD) and, where applicable, be accompanied by a closure plan so that it does not consist in a mere disposal of the most polluting assets.

In addition to these core recommendations, policymakers may wish to consider some or all of the following additional requirements amongst the future minimum standards:

6. **Manufacturers of Art.9 and Art.8 products could be required to adopt engagement policies and disclose them at the level of such products.** This would encompass, among others, how shareholder engagement is integrated to the investment strategy, how the investee companies are monitored and how voting rights are exercised as well as how dialogue is conducted with investee companies. This requirement would mean that no opt-out from the engagement policy rules of Directive 2007/36/EC (Shareholder's Rights Directive) is permitted for manufacturers of Art.9 and 8 products.
7. **Manufacturers of Art.9 and Art.8 products could be required to report on the principal adverse impacts (PAI) of their investment decisions regarding these specific products.** This reporting would be performed in accordance with Article 4 of SFDR, but would focus exclusively on investment decisions made in relation to the underlying assets of Art.9 and Art.8 products. Disclosures would be made at product-level to foster comparability between such products.
8. **A minimum proportion of Art.9 and Art.8 products' underlying assets could consist of investments in "transition assets".** We acknowledge that there is currently no clear-cut definition for such investments and that such description will remain qualitative at best. Indeed, on-boarding the concept of transition is a long-term goal which will require policymakers to design a precise definition of those assets or activities that may qualify as transitioning. The AMF sees at least two possible routes to devise a quantitative definition of transition (see box below), which would ensure that greenwashing is stymied. We acknowledge that such routes will require several years of legislative design.

¹ These approaches could for instance be « rating upgrade », "selectivity" and "non-financial indicators upgrade". They cover the vast majority of ESG practices developed by financial actors, such as best-effort, best-in-class or best-in-universe.

² A European regulatory framework for providers of ESG data, ratings and related services would be welcome to ensure the quality of the information used by financial actors in implementing these ESG approaches.

The way forward

This proposal aims to initiate discussions on minimum standards in the perspective of the announced review of SFDR. It intends to balance a high level of ambition with the reality on the ground and the recognition of current market practices. All recommendations were formulated based on practices observed in Europe and on regulatory provisions and tools that already exist.













This suggested framework has been designed to operate in a dynamic way, in line with future developments in the non-financial field. It voluntarily adopts an environmental prism, in view of the fact that social matters currently lack a robust methodology to underpin the notions of a company's/an investment's contribution to a social objective. In this respect, all constituents of the proposed definition of sustainable investment could be amended in the future to integrate a social dimension. Safeguards with regard to social and "Just Transition" considerations are however already built in the suggested criteria, thus enabling to control the practices of Art.9 and Art.8 financial products.

How to define "transition assets"?

At present, the AMF has identified two quantitative options to define "transition assets":

- **Option 1** - Financial actors could rely on the transition plans published by investee companies in accordance with CSRD. In that case, the mere existence of a transition plan would not suffice and the actual transition of the companies would remain to be demonstrated (i.e. whether the intermediate targets of the plan are effectively met), assessed and possibly quantified with a scoring. This demonstration could involve an external audit and be framed by precise rules on which external auditors would rely. It could for instance be based on the annual disclosures made by companies on their progress towards their objectives (see §15(h) of the draft European sustainability reporting standards E1).
- **Option 2** – In the future, the EU Taxonomy could be extended to distinguish between sustainable activities, harmful activities and activities standing in-between (the 'intermediate / amber' performance levels). As outlined by the Platform on Sustainable Finance in its report of March 2022 on '*Taxonomy extension options supporting a sustainable transition*', such an Extended Taxonomy would help define transitioning activities, and therefore "transition assets". Nevertheless, it does not exist today and will take time to be developed, if at all.

Synoptic table of the proposal for minimum environmental standards for financial products belonging to the Art.9 and 8 categories of SFDR

Art.9 products		Art.8 products	
THREE CRITERIA CONSTITUTING THE MAIN PROPOSAL		THREE CRITERIA CONSTITUTING THE MAIN PROPOSAL	
EU Taxonomy	 Minimum investments aligned with EU Taxonomy [no less than x%] + step-by-step increase	EU Taxonomy	 Reporting on the proportion of investments aligned with EU Taxonomy
ESG approach	 Binding ESG approach e.g selectivity with reduction of the universe by [30]%	ESG approach	 Binding ESG approach e.g selectivity with reduction of the universe by [20]%
Exclusions	 Exclusion of fossil fuel sector activities that are not aligned with the EU Taxonomy	Exclusions	 Exclusion of fossil fuel sector activities that are not aligned with the EU Taxonomy <u>unless they are committed to an orderly transition</u>
OTHER POSSIBLE CRITERIA OPTIONS		OTHER POSSIBLE CRITERIA OPTIONS	
Transition	 Minimum investments in the transition	Transition	 Minimum investments in the transition
Transparency regarding the engagement policy	 Transparency & monitoring of the engagement policy	Transparency regarding the engagement policy	 Transparency & monitoring of the engagement policy
Reporting on the consideration of principal adverse impacts	 Reporting on the principal adverse impacts (PAI)	Reporting on the consideration of principal adverse impacts	 Reporting on the principal adverse impacts (PAI)

LEGENDE :



Binding criteria for asset composition



Reporting to increase transparency